Overview

This study examines the impact of growth on poverty and inequality in Eastern Europe and the Former Soviet Union during 1998–2003. It updates the World Bank's previous study on poverty, entitled *Making Transition Work for Everyone*, which appeared in 2000. It asks three questions: What are the recent trends in poverty and inequality? Why do we see different outcomes across countries? And how can public policy help maximize the impact of growth on poverty reduction?

To measure poverty, an absolute poverty line of $2 a day[1] is used, comparing it with household consumption per capita. This line is a closer approximation to basic material needs in the Region than the well-known global standard of $1 a day because of the additional expenditures on heating and warm clothing that are required by the cold climate. Using an absolute—as opposed to a relative—poverty line allows us to focus on those who are deprived of the most basic needs, rather than those who may be deprived relative to their better-off fellow citizens. It also allows us to determine trends over time and make comparisons across countries, both of which would be difficult if we were using a relative notion of poverty. In addition to the $2-a-day poverty line, a $4-a-day line is used to capture the notion of "economic vulnerability," that is, to measure the proportion of the population that is not absolutely poor, but could become poor in the event of an economic downturn.

In terms of poverty levels, the Region is best thought of in four distinct subgroups of countries. The eight new member states of the European Union (EU-8) have low poverty (less than 5 percent) confined to specific subgroups of the population.[2] Countries in Southeastern Europe (SEE) have generally moderate levels of poverty (around 5–20 percent).[3] The same is true of the middle-income countries in the Commonwealth of Independent States (CIS).[4] The low-income countries in the CIS, however, have extremely high levels of poverty (more than 40 percent).[5] In addition to countries in these four subgroups, the Europe and Central Asia Region of the World Bank (ECA) also includes Turkey. Wherever possible, we treat Turkey as a "benchmark" against which to evaluate the performance of postsocialist countries in the Region. Turkey has moderate poverty. We also include two countries from outside the Region as benchmarks: Colombia (a middle-income country) and Vietnam (a low-income country).

Summary

The resurgence of growth in the eastern half of the Region, particularly in the CIS, resulted in a significant decline in poverty in the Region during 1998–2003 (figure 1):[6] more than 40 million people have moved out of poverty during this period. Where roughly 20 percent of the population (or one in five people) was living in poverty, today poverty affects only 12 percent (or one in eight people). While much of this poverty reduction has occurred in the populous middle-income countries in the Region (Kazakhstan, the Russian Federation, and Ukraine), poverty has fallen almost everywhere. During 1998–2003, poverty fell in most countries of the Region, except for Poland and Lithuania in the EU-8 and Georgia in the low income CIS group.[7] However, in the context of the EU-8, the low overall levels of poverty need to be borne in mind. Income (consumption) inequality showed no clear trend in the EU-8 and SEE; however, inequality declined in the CIS, with the notable exceptions of Georgia and Tajikistan.

At the same time that 40 million people have moved out of poverty in ECA as a whole, more than 60 million people remain poor, and more than 150 million people are economically vulnerable.[8] Progress on the nonincome dimensions of poverty—such as access to education, health care, safe water, and heating—is very mixed, with improvements in some cases and deterioration in others. In education, although access has improved, no subregion is free from countries experiencing declining standards. In health, no subregion is free from the growing epidemic of human immunodeficiency virus (HIV) and acquired immune deficiency syndrome (AIDS). Quite apart from HIV/AIDS and other communicable diseases, attaining the health Millennium Development Goals (MDGs) will prove difficult for many countries in the CIS and SEE because of the failure of health services to deliver adequate and timely services. Access to key infrastructure services—in particular lighting and heating—is actually deteriorating in some countries of the low income CIS group.

The single most important factor behind the significant decline in poverty in the period in question is high growth in the CIS, where the bulk of the poor reside. Combined with moderate levels of inequality, economic growth has delivered significant poverty reduction. To some extent, this rebound in growth rates in the CIS is unsurprising, although at the height of the financial crisis in Russia and neighboring contagion—which came at the end of a decade of difficult transition—it was hard to see the prospects for resumption in growth. A further factor influencing poverty reduction since 1999 is the reduction in consumption inequality in some countries of the CIS, which, too, can be viewed as a rebound from the levels observed in the 1990s.

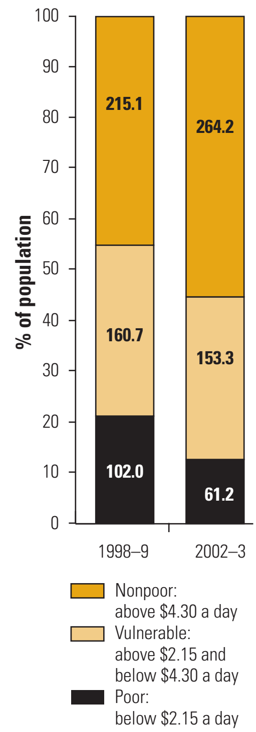
Because the substantial reduction in poverty is the result of a unique constellation of factors—rapid "catch-up" growth in the CIS accompanied by reductions in inequality in some countries—prospects for poverty reduction going forward are less propitious. Very few countries, even those that have made the most progress in reducing poverty, have been successful in creating jobs to fully replace those that have been destroyed. To some extent, reduction in overall employment was only to be expected, given the socialist legacy of high employment-to-population ratios. However, the failure to generate a sufficient number of jobs means that employment-to-population ratios have been falling, except in a few of the rapidly growing countries of the CIS. In the EU-8 and SEE, the employment ratio is well below what is found in Organisation for Economic Co-operation and Development (OECD) countries. If it persists, this failure to expand employment will fundamentally limit the poverty reduction impact of growth and act as a brake on further reduction of absolute poverty. This is an issue even in countries where poverty is relatively low (for example, Poland, where rising poverty is related to the growing divide between those with and without employment).

In addition to concerns on the jobs front, there is a marked regional and spatial dimension to both the income and nonincome dimensions of poverty in the Region. The most rapid declines in poverty have been observed in capital cities, as opposed to secondary cities and rural areas. In parts of the CIS, poverty rates are just as high in

FIGURE 1

More than 40 Million People Moved out of Poverty during 1998–2003

Distribution of Population by Poverty Status



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: In million persons and in percent to population. Poverty lines converted to local currencies using 2000 PPP. Data refer to ECA Region as defined by the World Bank, and Turkey is included in the aggregate figures.

secondary cities as in rural areas. Throughout the Region, the quality of public services is also poorer outside of capital cities, and trends are mixed, with some differences between capital and noncapital areas getting smaller and others larger.

Overall, there is a substantial agenda of reforms if countries wish to reduce poverty in all its dimensions over the coming years. While specific actions will vary from country to country, all countries need to focus on policies that will accelerate rates of growth and ensure that benefits are widely shared among the population. In addition, efficiency and equity concerns warrant strengthening delivery of education, health, and public utilities services, and enhancing social protection. It is also essential to monitor progress on poverty reduction.

Poverty and poverty reduction have a special significance in the Region that is different from that in other parts of the world. First, as mentioned previously, the cold climate means that the notion of "basic needs" has to be expanded to take into account the need for warmth. Only a small fraction of the population in the developing world would require a similar expansion of the basic needs set. Second, many countries in the Region completed the demographic and epidemiological transition a few decades ago. This graying of the population poses significant challenges for public policy, particularly where there are trade-offs involved in relation to the working (or the young) versus the elderly. There is also a greater burden of noncommunicable diseases, with implications for costs and access to health care. Again, there are few countries at equivalent levels of income that face a similar challenge. Finally, the legacy of the former socialist systems of production means that huge inefficiencies exist in the way production is organized, how infrastructure is deployed, and where people are located. Breaking with the past represents not only an opportunity but also a challenge.

Trends in Poverty in the Region, 1998–2003

Since 1998, absolute poverty at $2 a day (or, more accurately, $2.15 a day) has declined in most countries in the Region (figure 2). Two countries, Georgia and Poland, bucked the trend of declining poverty, and in another one, Lithuania, poverty was largely unchanged.

These trends, which are based on comparable consumption aggregates specially constructed for the purposes of this report, reflect the use of the latest purchasing power parity (PPP) exchange rates (2000 PPP) available for the countries of the Region. The use of different PPP revisions affects the ranking of a few countries in the Region, especially those that experienced hyperinflation or continue to practice administrative price setting, but leaves the overall extent of poverty and trends unchanged (see overview box 1).

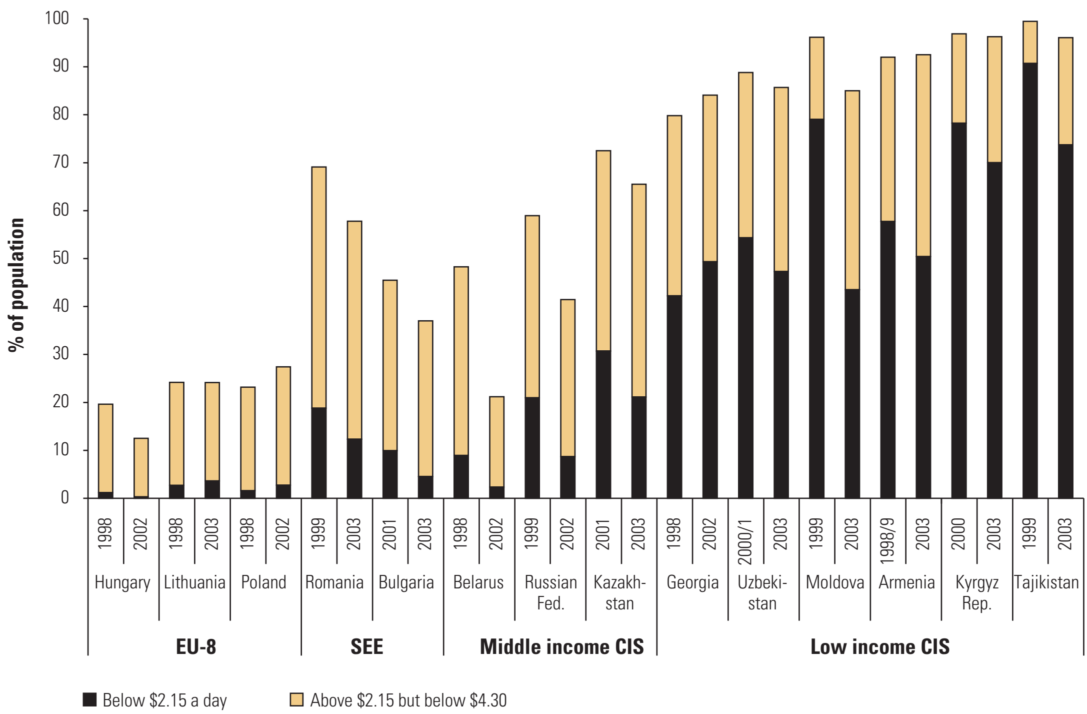
As it did five years ago, absolute deprivation varies enormously across the Region. At one end of the spectrum are countries in the low income CIS group such as Tajikistan, where the proportion of the population living on less than $2.15 per day is more than 70 percent, while at the other end are countries in the EU-8 such as Hungary, where absolute poverty, by this definition, is virtually absent. Countries fall into three broad groups: those with high poverty (all low income CIS countries), those with low poverty (typically EU-8), and those in between with moderate poverty (typically SEE and middle income CIS countries). These groupings are not hard and fast, with some countries in SEE (for example, Bulgaria) and the middle income CIS group (for example, Belarus) having low levels of poverty.

Even where incomes have grown and absolute material deprivation at $2.15 per day is low, the standard of living is not high, and

FIGURE 2

At the Country Level, Absolute Poverty Has Declined Almost Everywhere

Poverty Rates by Country



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: 2000 PPP.

OVERVIEW BOX 1

Using Purchasing Power Parity to Measure Poverty

An absolute poverty line, as the name implies, attempts to establish the value of consumption that a person needs to stay out of poverty, regardless of time and place. The first widely accepted global poverty estimates, produced by the World Bank's *World Development Report* in 1990, chose a poverty line measured in 1985 PPP. Chen and Ravallion (2001) have since updated these numbers, using 1993 PPP exchange rates for consumption. The PPPs were again updated for the Region in 1996, and this updated set was used by *Making Transition Work for Everyone* (World Bank 2000a).

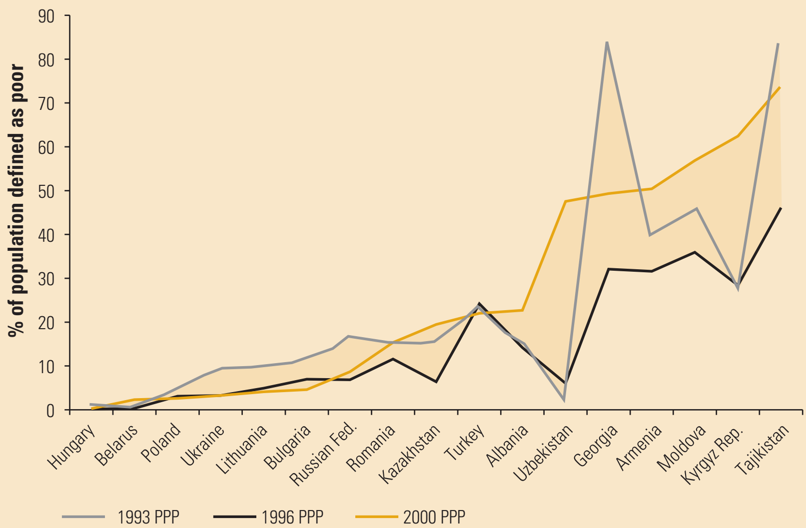
This report uses the most recent PPP numbers from 2000 (OECD 2003). More recent data on PPP are more relevant for the transition economies of the Region because they reflect contemporary (in many cases, liberalized) prices, as opposed to the administered prices of the past. For Turkey, a country without the legacy of an administratively directed economy, all PPP revisions produce approximately the same poverty counts (see figure). The economies of all formerly socialist countries exhibit significant changes, with more recent numbers being more plausible. For example, it is highly implausible that poverty in Uzbekistan is negligible (which is the impression that one gets using 1993 and 1996 PPPs and could be traced to widespread price controls in that country practiced during the 1990s). Errors can also go the other way (that is, overstate poverty), as appears to be the case when the 1993 PPP is used for Georgia. In addition to issues with relative prices, Georgia experienced hyperinflations around 1993, which would have made measurement of prices problematic. It would be incorrect to say that the 2000 PPP revision solves all comparability problems. Where interferences in market mechanisms continue, price surveys that form the basis for PPPs will deliver incorrect results (a factor that can be partly responsible for the low poverty headcount for Belarus).

large shares of the population are found to consume between $2.15 and $4.30 per capita per day. This group, while not absolutely deprived, is likely to have relatively low savings and is vulnerable to poverty in the event of shocks that affect earning potential.

Of course, an absolute poverty line of $2.15 a day (or some multiple) is one of many potential lines that could be drawn. Often what is relevant from the perspective of the poor is the level of resources that may be needed in the country context to be free from hunger, cold, and other forms of deprivation. In this report, the authors have chosen to use an absolute concept of deprivation, not only to focus more on those who are deprived in some "fundamental" sense but also to facilitate comparisons across countries and over time. The basic needs without which individuals would be

Poverty Rates at $2.15 a Day with Different PPPs

Countries Sorted by Poverty, Based on 2000 PPPs



Sources: Staff estimates; OECD 2003.

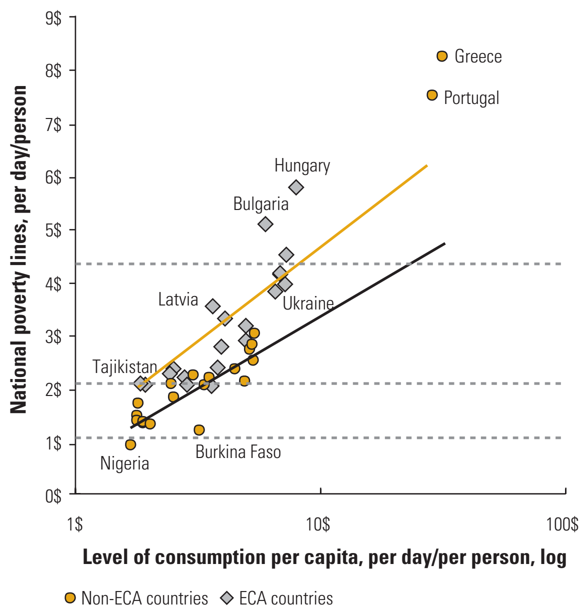
The total poverty headcount for the Region does not change much whether one uses the 1993 PPP or the 2000 PPP, although individual country assessments are affected. However, the 1996 PPP (with few exceptions: Bulgaria, Estonia, and Lithuania) produces a lower poverty count than the 2000 PPP does. It is important to note that only the ongoing global International Comparison Program (www.worldbank.org/data/icp/), expected to produce results by 2007, will address fundamental problems of all existing sets of PPP in their application to poverty comparisons. Internationally comparable poverty data produced for this study need to be interpreted with due caution.

Sources: World Bank staff; World Bank 2000a; Chen and Ravallion 2001; Kakwani and Sajaia 2004; and OECD 2003.

absolutely deprived are typically reflected in national poverty lines.[9] As might be expected, standards of income required to ensure against material deprivation in richer countries are higher, so national poverty lines are positively related to income levels. National poverty lines in the Region suggest that a poverty line around $2 per capita per day might indeed be a relevant absolute floor (figure 3). When compared with national poverty lines from a random selection of non-Region countries, the Region's poverty lines are found to be higher on average, perhaps reflecting the higher cost of basic needs due to the extremely cold climate in certain countries. However, high though they may seem, even the highest national poverty lines in the Region are substantially lower than poverty lines of two of the poorest EU-15 countries,[10] Greece

FIGURE 3

The Lowest National Poverty Line in the Region Is around Two Dollars a Day



Sources: Region: World Bank staff estimates; non-Region: Kakwani and Sajaia 2004 and OECD 2003; EU: Dennis and Guio 2004.

Note: Latest years of available data used, all values expressed in 2000 PPP $.

and Portugal. Using measures of absolute deprivation that are more consistent with national poverty lines but still modest (such as $4.30 per capita per day), it is evident that absolute deprivation continues to exist even in relatively well-off countries such as EU-member-state Hungary (figure 2).

How has poverty risk evolved in the past five years? Looking below the national averages on population subgroups, four characteristics stand out for raising poverty risk (that is, poverty incidence) above average: being young, living in a rural area or (in some cases) a secondary city, being unemployed, and having low levels of education.[11] Although not equally important in all subregions, these were the same groups identified as having a higher-than-average poverty incidence five years ago (World Bank 2000a).

Outside the low income CIS countries, children face a substantially higher risk of poverty than other population groups do. Relative poverty risk for children has actually increased in the past five years because poverty incidence has fallen less rapidly among families with children than for other groups (figure 4a).

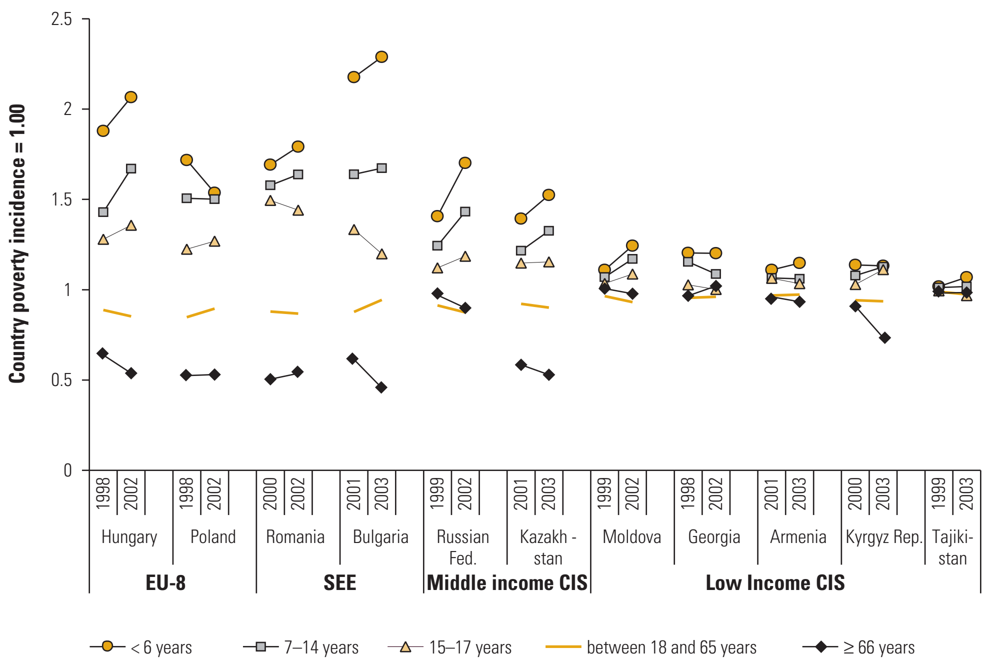
Residents of rural areas face a higher risk of poverty than those in cities do (figure 4b). Among the rural dwellers, children usually face the highest poverty risk, often multiple times the national average. But in some countries of the CIS, poverty risks are as high in secondary cities as in rural areas. Indeed, lumping capital cities together with other urban areas can be misleading because of the contrast between their positions. Over the past five years, with few exceptions, poverty has declined far more rapidly in capital cities than elsewhere. As a result, residents of rural areas and secondary cities face a far greater risk of poverty relative to capital city dwellers than previously.

Outside the low income CIS countries, the unemployed face significantly higher risks of poverty than the employed do (figure 4c). With the resumption of sustained growth in the CIS and an improvement in the position of the employed, the relative risk of poverty faced by the unemployed has increased significantly.

The risk of poverty falls with educational attainment. As shown in the report, over time, the risk of poverty of those with basic education

FIGURE 4a

Children Face a Greater Risk of Poverty than Other Population Groups; in Most Cases, This Risk Has Increased over Time

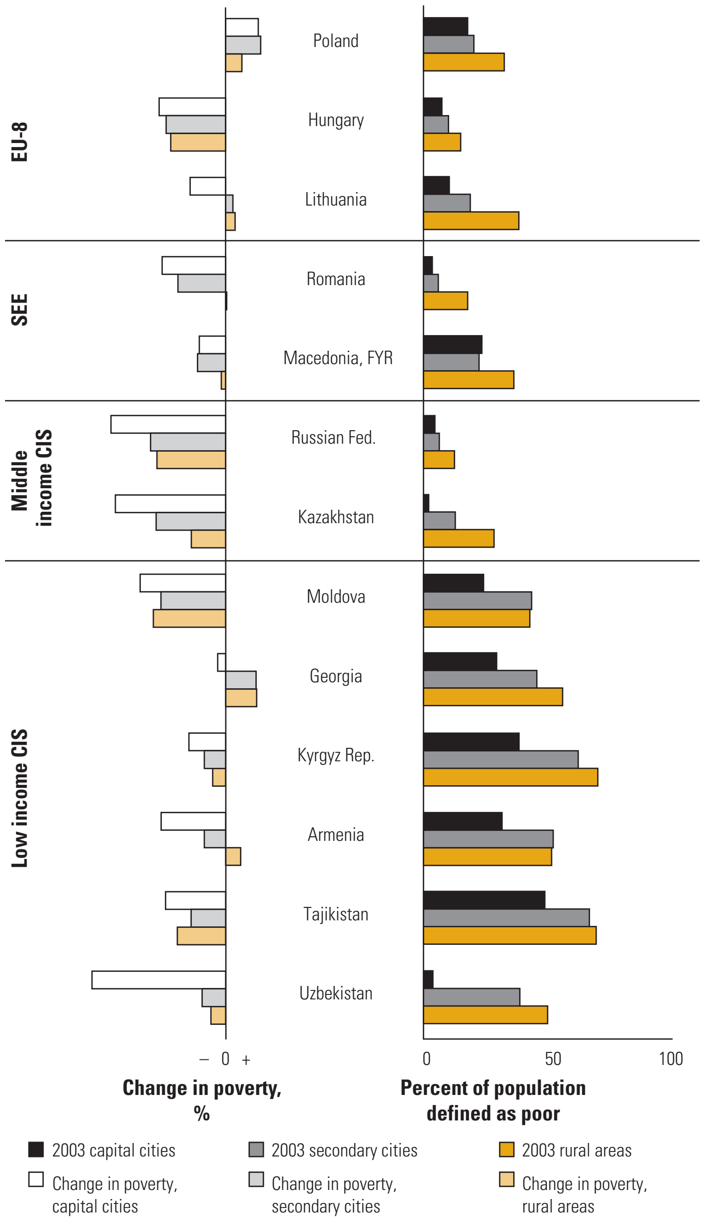


Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: 2000 PPP. Poverty line for the EU-8 and Bulgaria is $4.30 per day. Risk of 1 indicates that an age group is no more or less likely than the average to fall into poverty.

FIGURE 4b

Poverty Reduction in Secondary Cities and Rural Areas Has Lagged behind Capital Cities



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: 2002 data used instead of 2003 in Russia, Poland, and Hungary. The benchmark year to measure change is 1998, except in Kazakhstan, where it is 2001, Kyrgyz Republic and Uzbekistan (2000), and Tajikistan (1999). Poverty line for the EU-8 and FYR Macedonia is $4.30 per day; everywhere else it is $2.15 per day in 2000 PPP.

or less, relative to other groups, has increased, reflecting their handicap in benefiting from new economic opportunities.

Ethnicity is also associated with higher-than-average poverty incidence in some cases. Data on ethnicity are sometimes not covered in surveys, and even where they are, sample size may preclude any robust conclusions. While the data do not allow trends to be inferred, relatively strong evidence exists that in more than one country, groups such as the Roma of Central and Eastern Europe (CEE) face a substantially higher incidence of poverty than the general population does (World Bank 2001c; World Bank 2002g; and World Bank 2005e). Available evidence on other minorities is mixed, with some faring worse than average, such as the Turkish minority in Bulgaria or the Russian minority in Latvia, while others do better, such as the Russian minority in the Kyrgyz Republic or the Hungarian minority in Romania (World Bank 2003i; World Bank 2003k; World Bank 2004g). The relative position of minorities is a function of human capital and other endowments relative to the population as a whole and of their position in relations of power, which may vary from group to group.

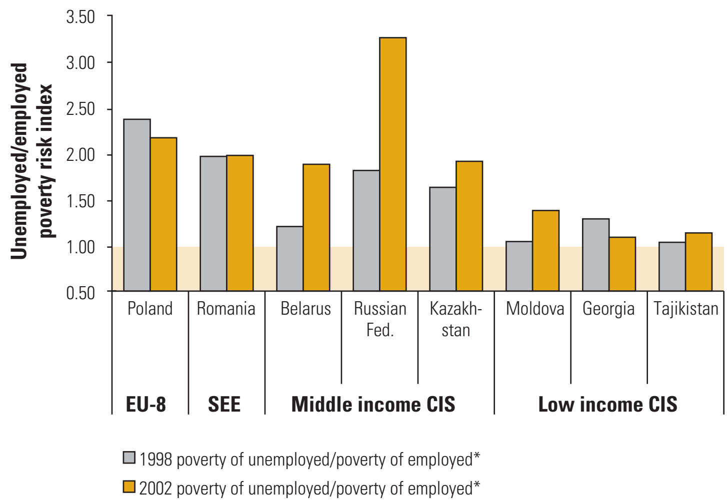
Within countries, poverty incidence shows marked variation, and there is evidence that regional differences are growing over time in some countries (figure 4d). This is because poverty rates have typically declined more sharply in capital cities and other prosperous areas of trade and tourism than in rural areas or secondary towns. In a related vein, many countries outside the low income CIS group (where information is more limited) show high and highly persistent differences in unemployment rates across regions.

Composition of the poor. Most of the poor in the Region comprise working adults and children, who between them account for 60–75 percent of the poor (figure 5). In most instances, poor children are children of working parents. This structure of poverty, with the predominance of working families (that is, households with working adults), is no different from that of the past, although the share of working families has declined. The next largest group comprises those out of the labor force, followed by the unemployed and the elderly.

With regard to location, urban and rural residents are evenly split, each constituting around 50 percent of the poor in the Region as a whole. This split is influenced by an interaction of higher-than-average poverty risk for rural residents and their relatively low share in the population. In relation to subregions, rural residents form the bulk of the poor in the low income CIS group (70 percent of the poor), SEE (62 percent), and the EU-8 (51 percent). The only subregion that

FIGURE 4c

The Unemployed Face Higher Risks of Poverty than the Employed; This Risk Has Grown over Time in the CIS

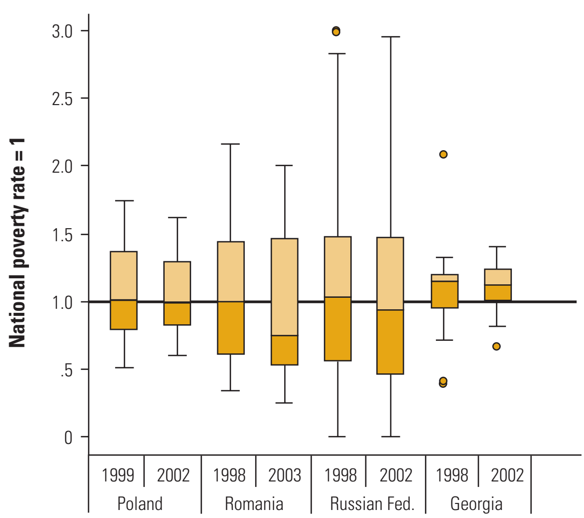


Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: For Kazakhstan, 2001 is used instead of 1998, and 2003 instead of 2002; for Tajikistan, 1999 instead of 1998 and 2003 instead of 2002. For Romania and Moldova, 2003 is used instead of 2002. For the EU-8 and Belarus, the poverty line is $4.30; everywhere else it is $2.15 a day in 2000 PPP.

FIGURE 4d

There Are Marked, and in Some Cases Increasing, Differences in Poverty across Regions



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: The box depicts the spread in regional poverty rates (boxes plot upper and lower boundaries, called interquartile range, of the interval where most of the regional poverty rates would fall, and the whiskers the extremes). Dots represent outlying regions in a statistical sense.

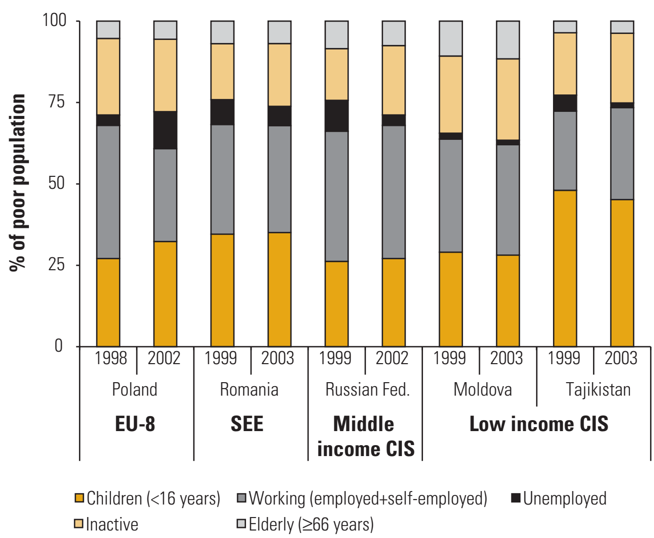
is dominated by urban poor is the middle income CIS group (only 41 percent rural poor).

Trends in poverty depth. At the end of the 1990s, the general understanding was that poverty in the Region, while widespread, was relatively shallow. The pattern five years later appears more varied, with the Region's countries now spanning a wide range (figure 6). Using Turkey, Vietnam, and Colombia as the benchmarks shows that poverty in the low income CIS group is fairly deep, but in the middle income CIS countries and SEE, it is fairly shallow. In the EU-8, the picture (relative to a $4.30 poverty line) is mixed, with examples of both shallow and deep poverty.

Trends in inequality. While there is no clear trend in the EU-8 and SEE, consumption inequality in the CIS declined (with few exceptions) between 1998 and 2003 (figure 7).[12] By 2003, consumption inequality in the Region as a whole looked broadly comparable to that in OECD countries and East Asia. While inequality in consumption does not appear egregiously high, subjective data suggest that people in the Region continue to find inequality to be excessive. This may be

FIGURE 5

Working Adults and Children Continue to Form the Bulk of the Poor in the Region



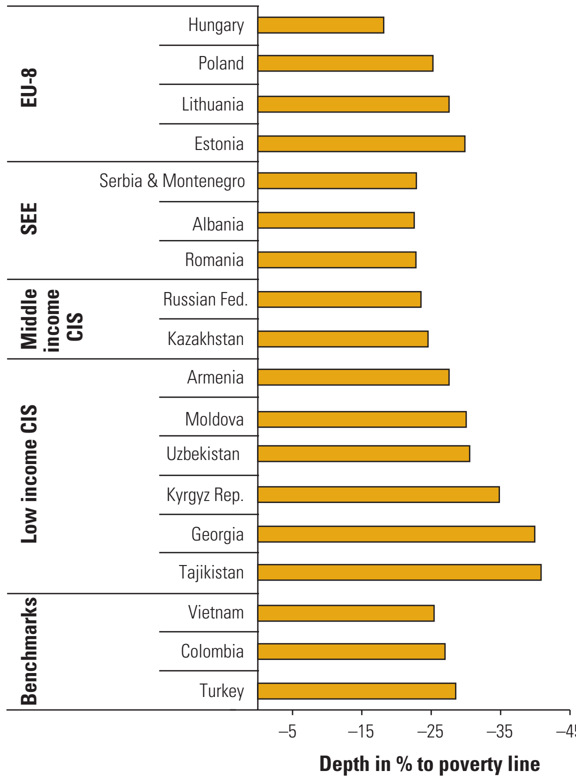
Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: For the EU-8 and Bulgaria, the poverty line is $4.30.

FIGURE 6

In Some Countries, Poverty Is Shallow; in Others, Deep

Deficit in Consumption of an Average Poor Person as Percentage of Poverty Line



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: For the EU-8, the poverty line is $4.30; everywhere else it is $2.15 per day per capita in 2000 PPP, latest year of available data used.

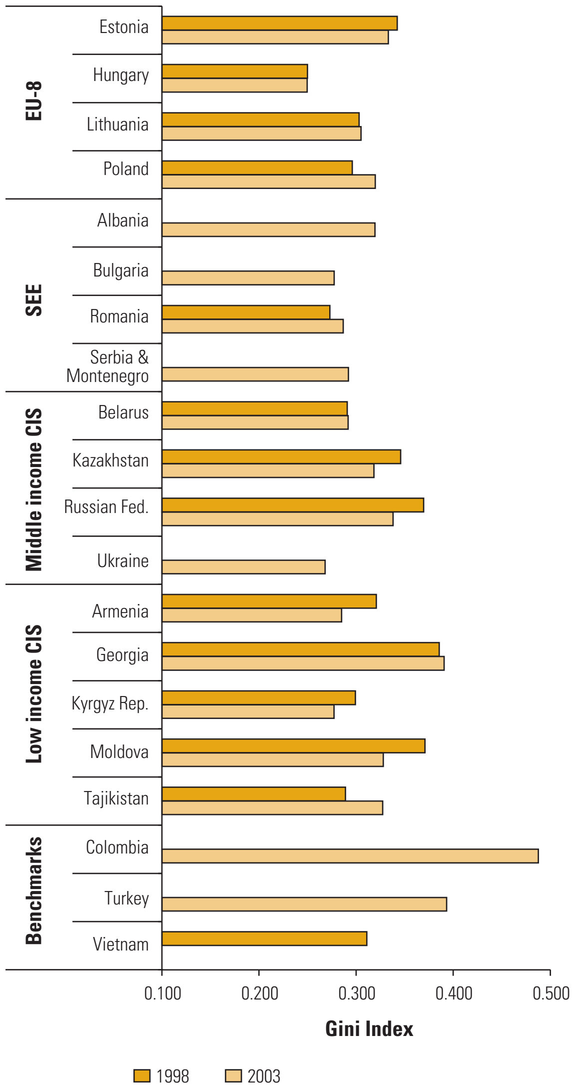
related in part to the fact that, despite recent falls in the CIS, inequality remains significantly higher than at the outset of the transition.

The decline in inequality in most of the CIS (with the notable exceptions of Georgia and Tajikistan) also runs counter to widely held perceptions that the "bounce-back" in growth has gone hand in hand with widening income differentials. There are at least three reasons why subjective and objective measures may suggest different trends.

First, changing relative positions of different population subgroups may leave overall inequality unchanged, but may lead to the impression of growing inequality. For example, the rise in the position of capital city dwellers relative to residents of secondary cities may leave overall inequality unchanged (as, for example, would be the case if the two groups simply switched positions in the income distribution), but may contribute to the perception of a growing divide.

FIGURE 7

While Changes in Distribution Have Gone Either Way in the EU-8 and SEE, They Have Moved in Favor of the Poor in the CIS (Georgia and Tajikistan Excepted)



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: Gini index for per capita consumption.

Second, measures of inequality typically employed in the literature (including in this report) are measures of relative inequality; however, subjective perceptions often relate to absolute differences in income, not relative ones. For example, if everyone's income increases by 10 percent, measures of inequality (such as the Gini coefficient employed in this report) would show no change in the distribution of income.[13] However, the absolute difference in the incomes of the rich and the poor would have increased (for example, 10 percent growth means a larger absolute increase in income for the rich than for the poor), contributing to a perception of growing inequality.[14]

Third, sampling and nonsampling errors mean that survey data may do a poor job of measuring income growth at the top of the distribution and thus may end up underestimating upward drift in inequality. This is a worldwide problem; however, if there is confidence in the quality of the data at the lower end of the distribution, one can be reasonably confident of trends in poverty and inequality in the vicinity of the poverty line. In the Region, because of data improvements in all but a handful of countries, the measured trends in poverty and inequality are robust.

Factors Contributing to Poverty Reduction, 1998–2003

Growth in output and wages. Since 1999, the growth of the gross domestic product (GDP) in the Region has been impressive (higher than the world average), with the CIS the most rapidly growing subregion. For the CIS, the recovery of growth in Russia has been an important factor. The devaluation that accompanied the financial crisis in Russia was important for restoring the exchange rate to a more competitive level and spurring the recovery of exports and growth. Combined with high prices for oil and other natural resources, this gave a huge boost to the Russian economy, which has in turn become a regional locomotive for many neighboring countries. Structural reforms that had been undertaken by many of the CIS countries enabled an improved supply response when the opportunity presented itself. For the EU-8, the prospect of accession provided a strong impetus for both reforms and growth, while the restoration of peace and stability in SEE was an important factor in sustaining recovery (figure 8).

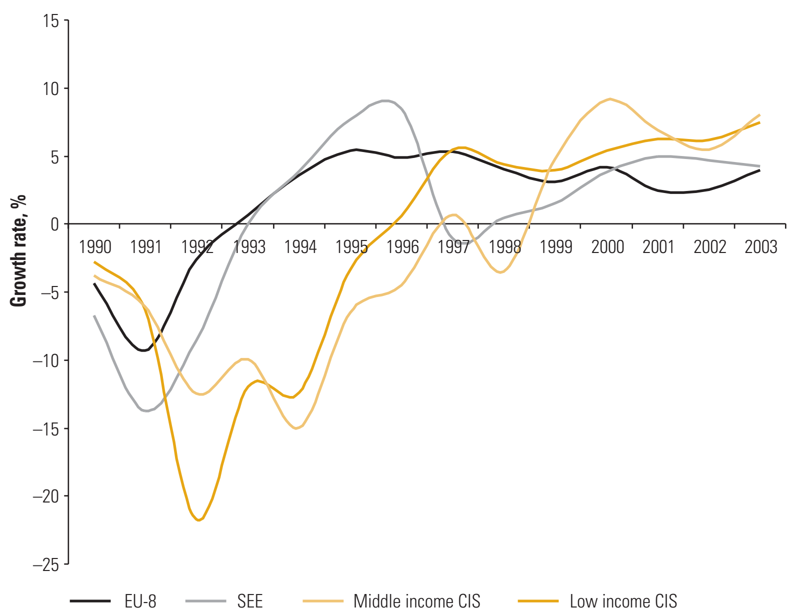
Mirroring the growth in output, there has been a sharp upswing in average wages in all economies in the Region. For example, in the low income CIS group, real wages have almost doubled since 1997. Data on wages by profession or by position in the income distribution suggest that this upswing has been shared alike by unskilled and skilled, poor and nonpoor. In most cases, wage increases have been larger than increases in productivity, reflecting in part the bounceback of wages from the very low levels observed in the late 1990s in the CIS and parts of SEE.

While growth has resulted in the creation of new and more productive jobs, only the fast-growing economies of the CIS have been able to create jobs at a sufficient pace to replace ones that were lost. Employment-to-population ratios have therefore stayed steady or declined almost everywhere outside the CIS (figure 9).[15] Because of the failure to engender sufficient job creation, the EU-8 and SEE are well below the Lisbon targets of 70 percent of the labor force in employment.[16] The position is somewhat different in the CIS, where employment levels tend to be higher and, in many cases, are trending upward (with some notable exceptions such as Georgia and Tajikistan). While some fast-growing countries have succeeded in increasing wage employment (for example, Russia), in many low-income countries the main source of employment growth has been through the expansion in self-employment (for example, Moldova).

Even where employment ratios are stable, there has been a continuing reallocation of labor across sectors. In most of the EU-8, agriculture employment fell, and its relative share of employment is now close to the EU benchmark. In contrast, agriculture employment increased in most SEE and low income CIS countries. Expansion of employment in services was observed in almost all countries in the Region.

FIGURE 8

Since 1999, Growth Rates in the Region Have Been High, with the CIS the Most Rapidly Growing Subregion



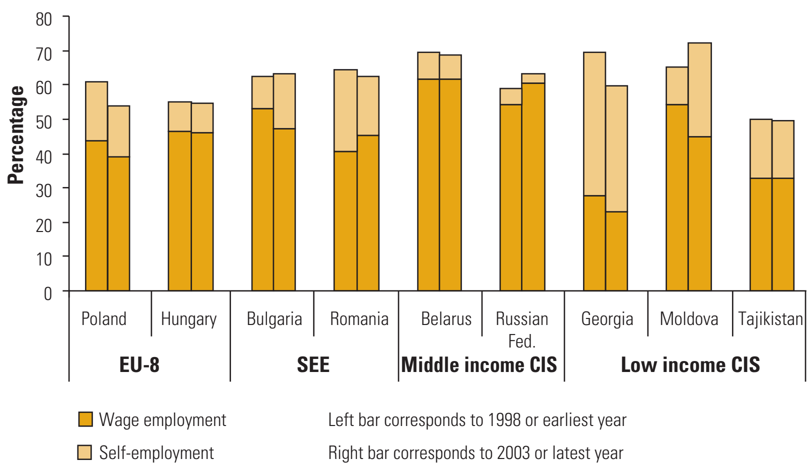
Source: World Development Indicators (World Bank 2005i).

What have these developments in the labor market meant for the poor? Growth incidence curves, which plot the increase in household income (consumption) by percentile, show that in most—but not all—cases, the poor saw a substantial increase in incomes during this period (figure 10). This is not surprising, given that at the start of this period, most of the poor consisted of households with working adults (World Bank 2000a) who would no doubt have benefited from the growth in wages across a range of sectors and professions. Little information exists on trends in earnings of the self-employed. One country where the income of the poor declined rather than increased, leading to an increase in poverty, is Poland.[17] Interestingly, this reduction in incomes for the poor coincided with significant employment reduction in the economy as a whole and for the poor.

Decline in inequality. As the growth incidence curves suggest, growth in incomes was proportionately higher for the poor than the rich in the CIS. This fact underlies the fall in inequality discussed previously. In contrast, in the EU-8 and SEE, growth was either pro-rich or pro-poor, depending on the country; therefore, trends in inequality are mixed. In the CIS, poverty reduction was aided by the fact that incomes of the poor grew more rapidly than those of the rich (that is,

FIGURE 9

Employment-to-Population Ratios Are Well below Lisbon Targets (70 percent) in the EU-8 and SEE and Often Trending in the Wrong Direction



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: Employment and self-employment levels are derived from household survey data and may differ from official statistics in some respects. Employment population ratio is a percentage of employed among the population of working age (16–64 years old).

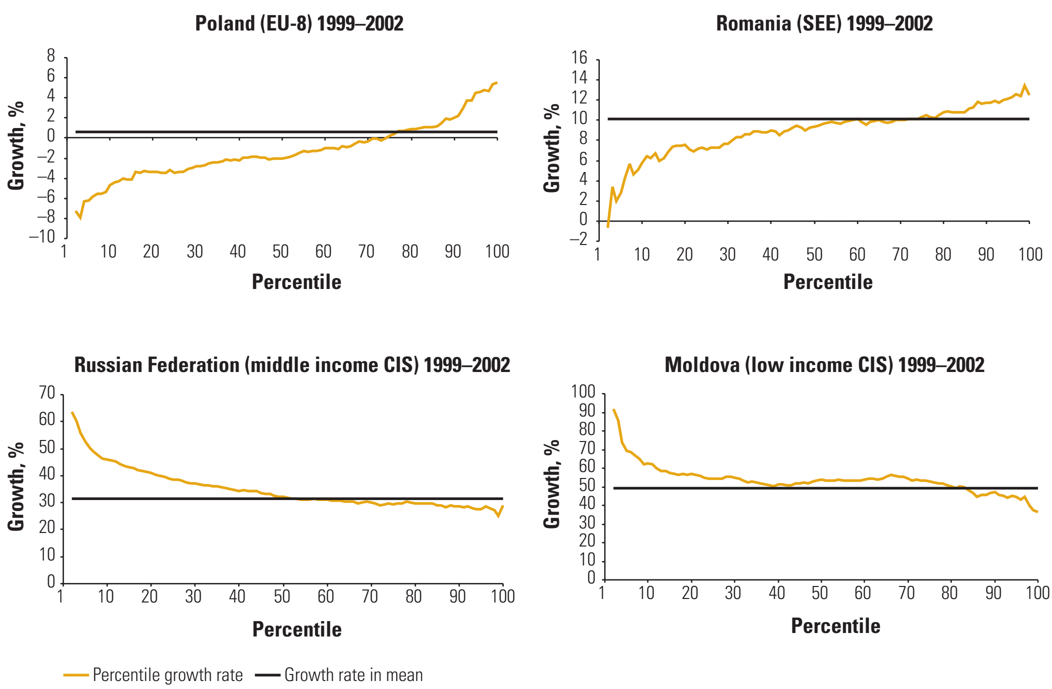
the distribution of income changed in favor of the poor). In contrast, in countries such as Poland or Romania, poverty reduction was hampered by the fact that the incomes of the poor grew more slowly than those of the rich.

What factors account for these changes in distribution? While there is no common pattern, there are some common trends across countries in the Region. In the CIS, declining wage arrears have been a feature of the economic recovery. Wage arrears were regressive in impact, driving up inequality among wage recipients (Lehmann and Wadsworth 2001); therefore, arrears reduction has likely been beneficial to equality. In contrast, in Poland and Romania, upward pressure on inequality from falling participation rates has been reinforced by rising inequality among wage earners. The latter is no doubt related to the further decompression in wages in these countries (World Bank 2003k; World Bank 2004h; World Bank 2005g).[18]

What were the roles of growth and changes in distribution in poverty reduction? Figure 11 plots the shares of growth and changes

FIGURE 10

The Poor Have Benefited More than the Rich from the Growth Rebound in the CIS



Source: World Bank staff estimates using ECA Household Surveys Archive.

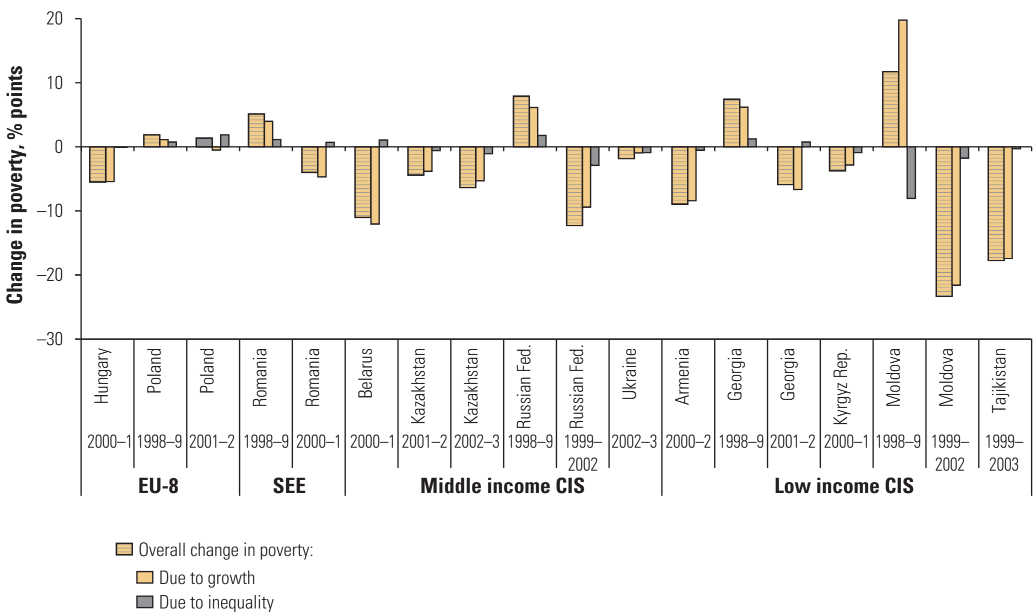
Note: Percentiles measure position in the distribution of per capita consumption from the poorest to the richest (100th percentile).

in distribution in poverty reduction for selected growth periods since 1998. The "growth share" measures how much poverty reduction can be attributed to growth in mean incomes on its own (that is, assuming no changes in the distribution), while the "distribution share" measures how much can be attributed to changes in the distribution of incomes alone, assuming no change in mean income. Figure 11 highlights the overwhelming importance of growth to poverty reduction over the period in question. Relative to growth, the contribution of changes in distribution to poverty reduction has been relatively small. But as small on average as they appear, changes in distribution have clearly been quite important in some countries. For example, in Poland in 1998–99, 40 percent of the increase in poverty is attributable to the increase in inequality, while 60 percent is attributable to the decline in income. In a number of countries in the CIS, the share of changes in distribution to poverty reduction in the period since the end of the financial crisis is more than 20 percent.

Role of public transfers. In addition to wages, public transfers are an important component of household income and play an important role in poverty reduction. In most countries, social protection benefits

FIGURE 11

The Share of Growth in Poverty Reduction Is Dominant across All Regional Subgroups



Source: World Bank staff estimates using ECA Household Surveys Archive.

have increased in the past five years in real per capita terms, along with the growth of fiscal revenues. Where data are available, they suggest that benefits have also improved in both coverage and adequacy. The reduction in arrears, particularly in pensions but also in other benefits, has no doubt contributed to these improvements. As a result, social protection transfers have come to play an important role in reducing poverty. Indeed, poverty would have been significantly higher in a hypothetical "no-transfers" situation (overview table 1). While somewhat simplistic, particularly in assuming no behavioral response in the no-transfer scenario (except in a few instances), the data are nonetheless illustrative of the importance of public transfers to poverty reduction, especially outside the low income CIS group.

Private transfers. In the low income CIS countries and parts of SEE, remittances and other private transfers by far exceed publicly provided resources. In some cases, remittances accounted for more than 10 percent of GDP and boosted consumption levels, including among the poor, helping to reduce poverty; however, the size of the impact is difficult to estimate because of various data limitations (Chernetsky Forthcoming).

OVERVIEW TABLE 1

Transfer Payments for Social Protection Have Had an Important Role to Play in Reducing Poverty outside of the Low Income CIS Countries

Country	Year	Increase in poverty without all social transfers, %
EU-8		
Poland	2001	141
SEE		
Bosnia & Herzegovina	2001	68
Bulgaria	2001	156
Romania	2002	49
Serbia	2003	41
Montenegro	2002	34
Middle income CIS		
Belarus	2002	143
Kazakhstan	2002	100
Russian Fed.	2002	68
Low income CIS		
Armenia	2001	12
Kyrgyz Rep.	2001	10
Benchmark Countries		
Vietnam	1998	5

Sources: For ECA, World Bank, various poverty assessments; for Vietnam, Van De Walle (2002).

Note: Simulations use national poverty lines. Some behavioral response is assumed in Romania (50 percent of transfer income is replaced) and Serbia (72 percent of transfer income is replaced in rural areas, 87 percent in urban areas).

The impact of public and private transfers on inequality is mixed. Parts of the public transfer system, such as well-targeted social assistance programs, can be fairly progressive. Others may be regressive. The largest program in most countries, however, is the public pension program, which tends to be distributionally either neutral or regressive. The overall impact thus varies from country to country, with examples of both fairly progressive and fairly regressive systems in the Region. Unfortunately, there has been little systematic study of the contribution of public and private transfers to changes in inequality over this period.

Nonincome Dimensions of Well-Being, 1998–2003

What are the trends in the nonincome dimensions of well-being? Although there has been a reduction in poverty, trends in the nonincome dimensions of well-being, such as access to education, health care, safe water, and heating, are markedly variable. Inequalities in access, whether to good schooling or health care or reliable water and electricity, persist and in some cases have increased, particularly in the CIS. In these countries, many people have thus come to have more income in their pockets, but in access to services and quality of services they may be no better off.

Education. The most acute form of education deprivation is illiteracy. Average literacy among the transition countries of the Region is high (more than 98 percent), and in the transition country with the lowest level of literacy (Tajikistan), 96 percent of adults are literate. In a benchmark country, Turkey, literacy was much lower to start with and, despite increases, stood at just 87.5 percent in 2002. Thus, the extreme form of education deprivation does not appear to be a major issue in the Region.

Since 1998, many countries in the Region have maintained or improved their high levels of school enrollment. Most countries entered the 1990s with a widespread network of education services that enabled them to achieve almost universal coverage in compulsory education. However, some of these achievements were eroded during the 1990s, particularly among the low income CIS group and some countries in SEE, although, even with the decline in coverage, enrollment in the compulsory cycle was typically higher than in comparator countries. Since 1998, enrollment in the compulsory cycle has been maintained or improved, except for some poor countries such as Georgia, the Kyrgyz Republic, and Tajikistan, which have still not managed to arrest the decline (figure 12). While there is evidence of some income gradient in enrollment, with children from better-off households having better coverage, the gradient is not large. Continuing high coverage in most countries of the Region suggests that the prospects for meeting the MDG of universal primary enrollment are fairly good (World Bank 2005c). Gender inequality in compulsory education has not been an issue, except in Tajikistan, where it continues to warrant attention.

Compared with the primary level, enrollments at the secondary level have increased throughout the Region. This increase has generally been accompanied by a reduction in enrollment gaps across income groups, except in a few low income CIS countries. Urban-rural gaps have also been reduced in virtually all countries. Interestingly, gender inequalities at this stage of education favor girls. The exceptions to this are Bulgaria and Tajikistan. Although the ratio of female to male enrollments in Tajikistan has increased over the past five years, it continues to be low by the standards of the Region.

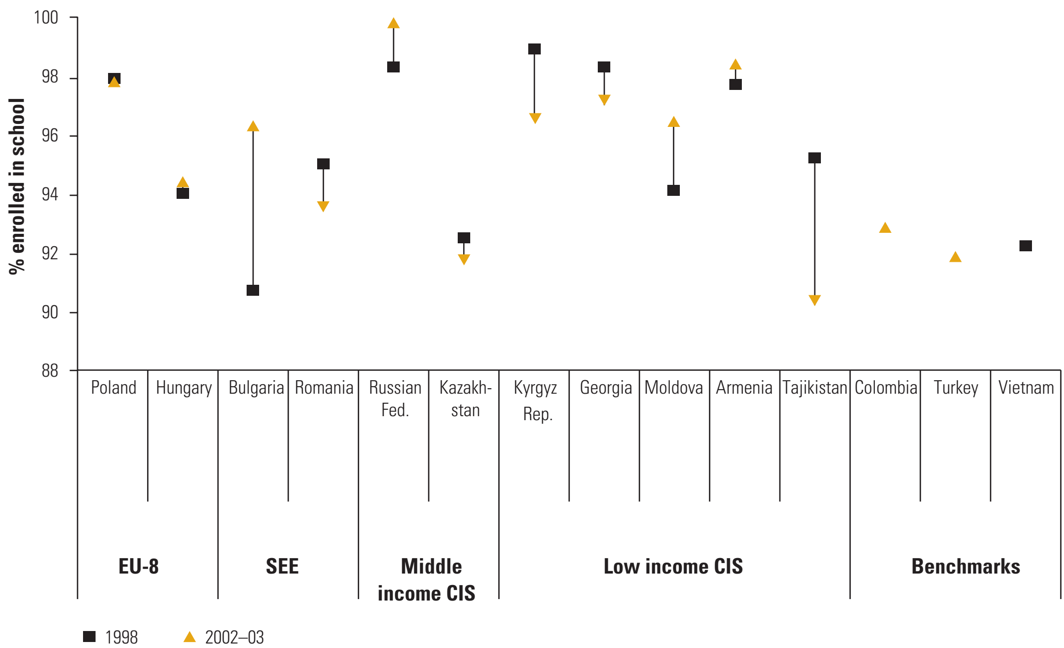
Returns to education, which were highly variable during the 1990s, particularly in the CIS, have now stabilized at levels similar to those of market economies. This underlines the value of investment in education, not only for its own sake but also as a means for ensuring adequate standards of living, particularly for the poor. However, returns are a function not simply of access but also of quality of education. Compared with enrollments, trends in quality of education are less sanguine. Despite increases in spending on a real per capita basis almost everywhere in the Region, the failure to invest sufficiently in the quality of infrastructure or staff means that quality is not being maintained. For example, Trends in International Mathematics and Science Study (TIMSS) data suggest that although performance of eighth graders continues to remain good relative to those in other countries, including those in OECD countries at higher levels of income, scores are declining in all but a handful of countries in the EU-8. Where the analysis is available, it suggests that the declines are in large part due to a sharp increase in the share of students who are seriously underperforming. Often, these students tend to be in schools where the quality of service provision is marginal, such as rural schools. Reading scores of 15-year-olds from the Programme for International Student Assessment (PISA) present no different a picture. Apart from a small handful of countries in the EU-8, scores are declining or low.

Health care. Trends in health status and health care utilization are mixed. Declines in male life expectancy (particularly in the successors of the Former Soviet Union), which had become one of the most

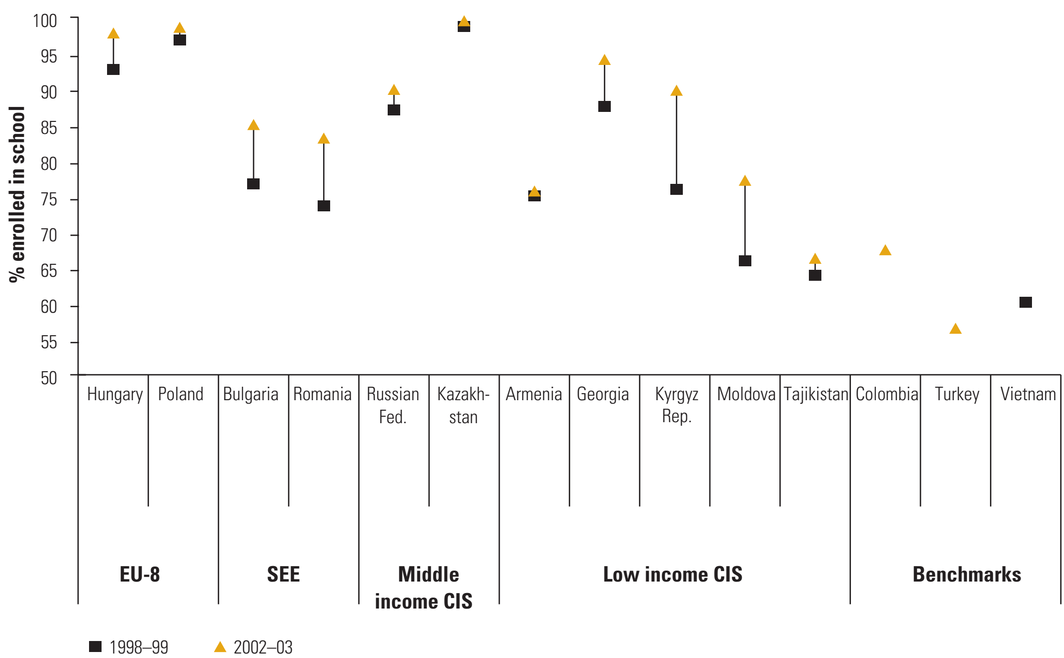
FIGURE 12

Access to Secondary Education Has Gone Up Virtually throughout the Region, but Some Countries Continue to Struggle to Arrest the Decline in Primary Enrollment Rates

Enrollment in Primary Education (7–14 years)



Enrollment in Secondary Education (15–17 years)



Source: World Bank staff estimates using ECA Household Surveys Archive.

widely documented negative health outcomes of the transition, have generally been arrested. However, many of the proximate causes of high male mortality, notably the high incidence of cardiovascular and circulatory disease and death from accidents and acts of violence, remain. As with male life expectancy, child and maternal mortality are also trending in the right direction. However, the very slow progress in achieving reductions in mortality and concerns about the delivery and quality of critical medical services imply that many countries in the CIS appear unlikely to meet the child and maternal mortality–related Millennium Development Goals (MDGs) (World Bank 2005c).[19]

There is a growing threat to the health of the Region's population from HIV/AIDS and tuberculosis (TB), particularly in the CIS, but also to some extent in SEE and the EU-8 (the Baltic countries). The Region as a whole currently has one of the most rapidly growing infection rates of HIV/AIDS in the world, due to problems related to the increase in injecting drugs and commercial sex work, a concurrent increase in the incidence of sexually transmitted infections (STIs), high migration rates, limited capacity of governments and civil society to implement effective preventive responses, and low levels of awareness of HIV and STIs. Drug transit through the CIS and growth of local consumer markets for drugs are also contributing to the problem. At current rates of infection and treatment, the HIV/AIDS MDG is unlikely to be attained by a broad swath of countries in the Region (World Bank 2005c).

Countries in the Region have a large network of public health providers that distributed generous services and that suffered major fiscal restrictions during the 1990s. Between 1994 and 1999, countries in the Region spent on average 4 percent of GDP on health, ranging from 1 percent in Georgia (low income CIS group) to 9 percent in Croatia (SEE). After 1999, some countries in the low income CIS group continued to experience reductions in public spending on health. Other poor countries were able to stem the decline in spending, but only at very low levels of spending (for example, Armenia). Even where funding may be on the upswing, outside the EU-8 it is not close to levels experienced at the outset of the transition.

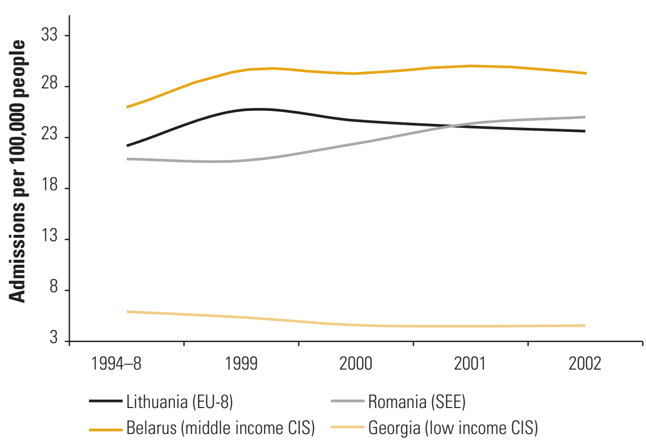
While funding levels may have stabilized or even increased, this is not reflected in improving quality, particularly for the poor, because of three factors. First, the very large network of providers has largely been retained, resulting in an underfunded, and hence ineffective, network in many countries. Second, the lack of resources for basic interventions like public health activities has resulted in a repeated failure to stem communicable diseases. Third, the changing demographic composition of the population (which is becoming older) has altered the morbidity profile and increased the costs of health provision. Vulnerable population groups (such as rural or small-town dwellers or the poor) are expected to have borne the brunt of not only the misallocation but also the failure of resources to keep pace with needs.

The lack of public resources increased the use of fee-for-services in a mostly unregulated setting, reducing the demand for health care. Official statistics show the decline in utilization of health care during the 1990s, but after 1999, this remained stable or even recovered (figure 13). Inpatient care in the low income CIS group declined more than 20 percent between the mid-1990s and 2000, only to stop after 2001. Countries in the middle income CIS group continue to have very high hospital utilization rates, higher than the EU average. Survey data on utilization, which control for need, suggest a similar picture, but point in many cases to persistent differentials across rural and urban areas, particularly in the CIS.

Infrastructure. Turning to infrastructure, here too the picture is very mixed. Data problems make this a particularly difficult area to analyze. However, what is clear is that countries of the Region began transition reasonably well covered with basic utility services, but the economic shocks of the early reform years left providers strapped for funds, which meant that utilities deteriorated Regionwide for much of the 1990s. Since then, the decline in utility performance (as measured by access and quality) has been reversed or slowed. Electricity has shown

FIGURE 13

Hospital Utilization Rates Have Recovered, but Remain at Low Levels in Parts of the Low Income CIS Group



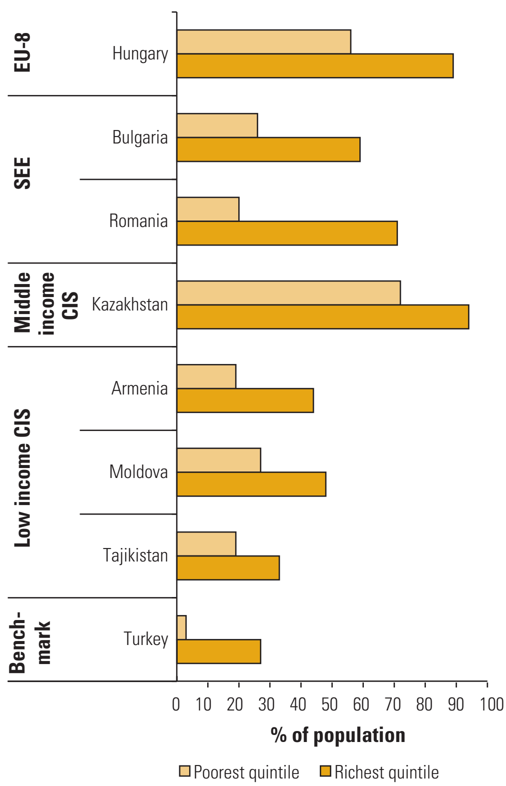
Source: World Health Organization (WHO), based on official statistics of hospital admissions.

the greatest improvement: providers have maintained near universal coverage while improving reliability in subregions where it was particularly poor, such as in the low income CIS countries. Other recent gains include the expansion of gas supply networks to many households affected by the collapse in district heating, and the improvement of water reliability in some countries. Despite these improvements, many households, including many urban households in the CIS and in some parts of SEE, continue to use dirty fuels such as coal, wood, and oil for heating because they lack access to gas and cannot afford, or are not reliably provided with, electricity. Available survey evidence suggests that the reliance on solid fuels for heating affects the poor more than the rich (figure 14). This could have a long-term impact on the health of the poor due to the negative impact of increased indoor pollution. Over the past five years, access to clean heat has become less

FIGURE 14

The Poor Make Greater Use of So-Called Dirty Fuels for Heating

Percentage of Population Using Clean Sources of Heating in the Poorest and the Richest Quintiles (Latest Available Year)



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: Clean fuels are all sources of heating for a household except solid fuels such as wood and coal, which are classified as "dirty."

equal in some countries of the low income CIS group (for example, Armenia), although in others (such as Tajikistan), the revival of district heating has improved equity.

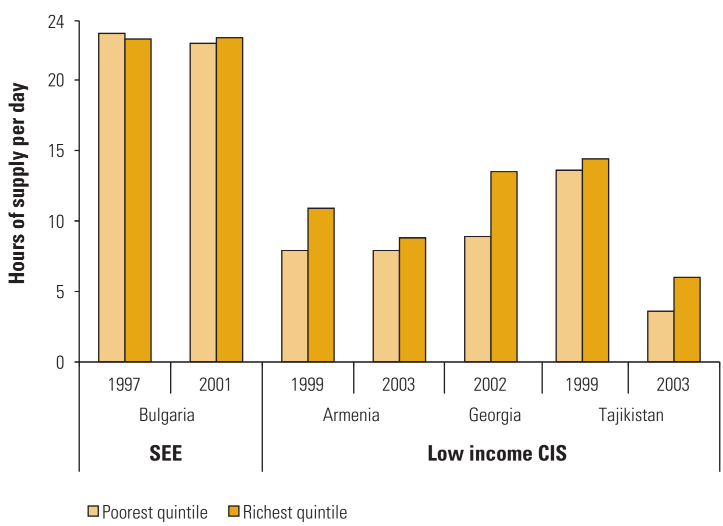
Although time-series data tracking water availability are available for only a few countries, the evidence from the low income CIS countries shows the influence of years of little maintenance and no investment in water provision (figure 15). Although households officially still have water connections, little water flows through the pipes. On average, Tajik households receive water for less than six hours each day, and although not depicted here, households in smaller cities and rural areas have the least water.

Are key public services affordable? Both catastrophic health spending and the additional cost of utilities pose the challenge of affordability for the poor. Household expenditure shares for utilities have continued to increase from the late 1990s to the present (figure 16). They are typically higher for poor households than for rich ones. On average, however, expenditure shares are highest in the EU-8, followed by SEE, the middle income CIS countries, and the low income CIS group, as shown in the figure. The increase in utility expenditure shares is largely driven by the increasing cost of electricity and, in the EU-8, the price of water.

FIGURE 15

In the Low Income CIS Countries, the Reliability of Water Supply Is Low and Shows Little Improvement

Access to Uninterrupted Water Supply

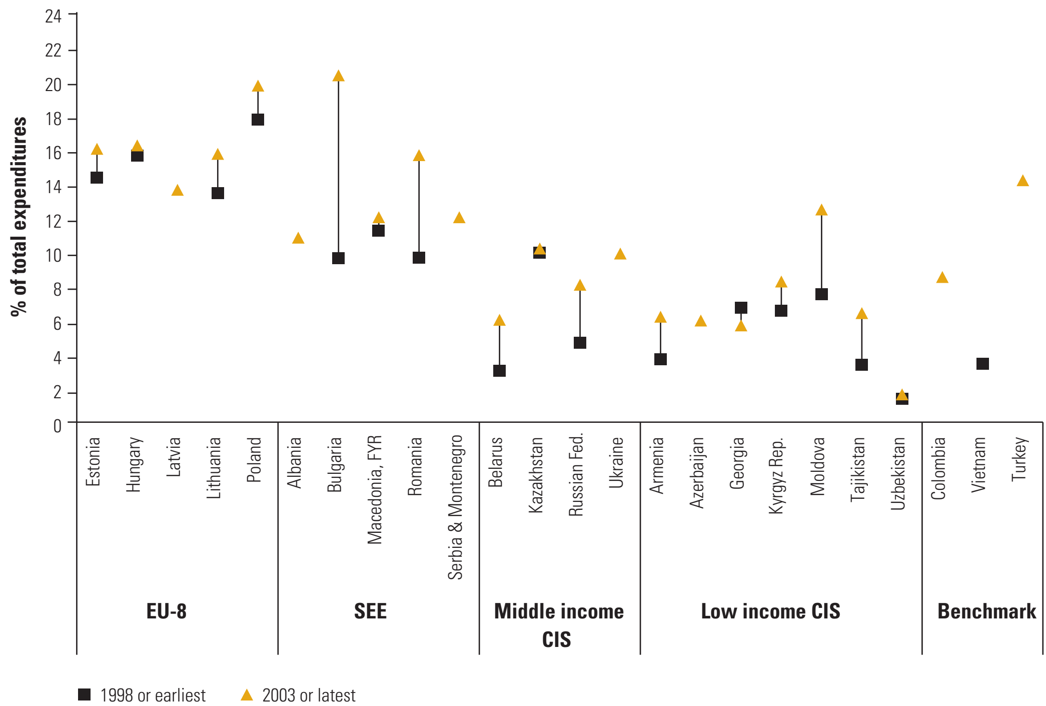


Source: World Bank staff estimates using ECA Household Surveys Archive.

FIGURE 16

Household Expenditures on Utilities Have Increased

Expenditure Shares on Electricity, Heating, Water, and Sewerage



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: For Albania, Latvia, Ukraine, Serbia and Montenegro, Azerbaijan, Turkey, and Colombia, data before 2002 are not available. For Estonia, Armenia, Kyrgyz Republic, and Uzbekistan, 2000 is used instead of 1998; for Tajikistan, 1999; and for Kazakhstan, 2001.

Catastrophic health expenditures run the danger of impoverishing households in parts of the Region such as the low income CIS countries, where the health system relies heavily on household contributions and households are relatively poor. Outside the EU-8, where the impact is more limited because of higher incomes, simulations undertaken for the purposes of this report suggest that catastrophic health spending can increase the fraction of the poor population by 3–9 percent.

Prospects for Poverty Reduction

Given what has been achieved, what are the prospects for poverty reduction? In drawing lessons, it is worth reminding ourselves of the main concerns five years ago when *Making Transition Work for Everyone* (World Bank 2000a) was published. Then, although growth had recovered in the EU-8 and parts of SEE, recovery was slow at best in the CIS, where most countries suffered an additional blow because of the financial crisis in Russia. The collapse in output, particularly in the CIS, combined with the increase in inequality, meant a sharp increase in poverty. Prospects for poverty reduction were felt to be unclear even in the event of the resumption of growth because a core group of the very poor—the long-term unemployed and socially excluded—were likely to be bypassed by growth. Despite notable achievement in the pretransition period, education and health sectors were under strain and working to the detriment of poor families and the economic mobility of their children. And to top it all, data issues clouded researchers' understanding of poverty.

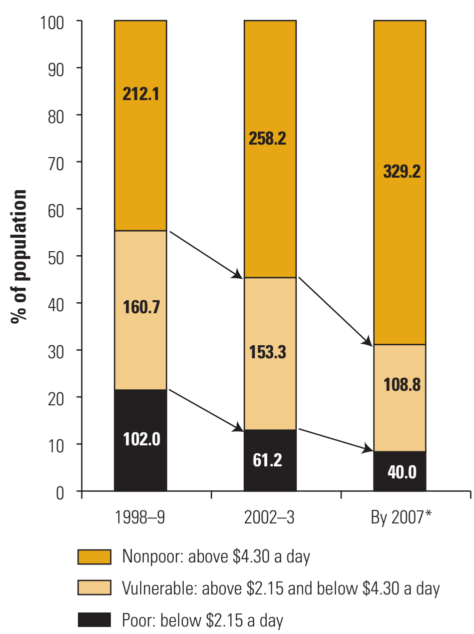
The picture looks different five years later, and one's understanding of the challenge of poverty needs to be suitably nuanced. Economic growth has firmly returned to the Region, and all countries are experiencing positive growth. In addition, changes in inequality have been modest over this period. Moreover, in the CIS, which had previously seen the sharpest increases, inequality has (with the few exceptions noted previously) abated. The rise in output and the moderation in inequality have together meant a substantial reduction in poverty.[20] The long-term unemployed and the socially excluded remain a concern, particularly because very few countries outside of the rapidly growing economies of the CIS have succeeded in raising the share of the population that is employed. However, the failure to raise overall employment levels has not acted as a brake on poverty reduction to date (except perhaps in a few countries such as Poland) because, in most countries, the bulk of the poor retain some attachment to the labor market and have benefited from the bounce-back in real wages. The health and education sectors in most countries have benefited from increased levels of funding, but because of remaining inefficiencies in delivery, this has not translated into uniform improvements in quality. Access is possibly less of a concern, with poor quality and high cost (or reduced affordability) becoming key dimensions of deprivation. The quality of data has improved, encouraging more confidence about observed trends. At the same time, shortcomings remain, especially with regard to data on the quality dimension of public services.

However, while the picture looks somewhat different, and notwithstanding the impressive reduction in poverty in the Region over the past five years, it is clear that there is a long road ahead, not just for the low income CIS countries but also for many middle-income countries in the Region (where poverty rates are lower, but where most of the poor live). This is for a number of reasons. First, despite the recovery, poverty rates remain significant: for many countries, it will be some time before absolute poverty is eradicated (on this, see further below). Second, the recovery is still recent for many, if not most, countries, and large numbers remain vulnerable to poverty in the event of an economic downturn. Third, despite recent improvements, morale (as revealed in self-reported assessments of well-being) remains low compared with that of countries at similar levels of income. This may be related to uncertain prospects for the future. Low morale may also be related to greater inequality and erosion in access and quality of public services compared with the past.

Projecting poverty rates over the medium term, using available economic growth forecasts from the World Bank's *Global Economic Prospects 2005*, indicates that poverty will not disappear altogether and, together with economic vulnerability, will affect 30 percent of the population by 2007. This is not to say that there will be little poverty reduction. In fact, poverty will fall by 7 percent a year, or 21 million fewer people will be in poverty in the five years covered by the forecast period (figure 17). Impressive though this reduction may

FIGURE 17

Growth Will Move an Additional 21 Million People out of Poverty by 2007, but 40 Million Will Remain Absolutely Poor and More Than 100 Million Vulnerable to Poverty



Source: World Bank staff estimates using ECA Household Surveys Archive.

Note: Growth rates for 2002–2007 are from the World Bank's *Global Economic Prospects*. * = simulations.

OVERVIEW BOX 2

Nonincome Dimensions of Poverty and Millennium Development Goals in the Region

Of the Region's subregions, the EU-8 is perhaps the least challenged by the nonincome dimensions of poverty. Most countries have met, or are likely to meet, all of the nonincome MDGs. However, for the Baltics, current trends suggest that the spread of HIV/AIDS may not be effectively combated.

The nonincome dimensions of poverty are likely to challenge some countries in SEE. It is not clear that countries such as Bulgaria and Romania will be able to combat the spread of HIV/AIDS. Romania may also struggle to meet the water access MDG because only 16 percent of the sizable rural population is assessed to have access to an improved water source.

The nonincome dimensions of poverty, particularly related to health, are likely to challenge the middle income CIS countries. None of these countries is assessed as likely to be able to combat the spread of HIV/AIDS. The targets for reductions in child mortality and maternal mortality may also not be achieved in some countries. It should be pointed out, however, that because of the age and epidemiological profile of these countries, proportionately higher gains in life expectancy would accrue from reducing adult mortality through the control of noncommunicable diseases than from achieving targets related to the MDGs.

The low income CIS countries are most severely challenged on nonincome dimensions of poverty. Most MDGs are unlikely to be met in the low income CIS group. Indeed, only the MDG regarding attaining gender equity in schooling is on track.

In benchmark Turkey, the nonincome dimensions also represent a challenge. In particular, even though the gender gap has been closing, girls are significantly underrepresented in primary and secondary schools. The MDG for maternal mortality also appears unlikely to be achieved, with maternal mortality rates unusually high for a middle-income country.

Source: World Bank 2005c.

be, some 40 million people are projected to remain absolutely poor in the Region by 2007. Naturally, faster growth could lead to faster reduction of poverty rates. Sustained economic growth is hence a crucial component of any poverty alleviation strategy. These projections do not incorporate any worsening of the income distribution, which would undermine the impact of growth. Given that inequality levels in the Region are, broadly speaking, at the low end by world standards, some worsening of inequality over the medium term would not be surprising. These projections should therefore be understood as a best-case scenario.

Looking behind the regional aggregates and using subgroups' specific targets indicate that all country subgroups face challenges in poverty reduction over the longer term. A forward-looking agenda could, for example, aim to meet the MDG on poverty—halving absolute poverty by 2015 compared with 1990 levels—which is most relevant for the low income CIS countries. For the middle income CIS group and SEE, which have moderate poverty, the MDG is not sufficiently ambitious. Eliminating economic vulnerability, which this report takes as having income (consumption) levels that are above twice the poverty line, is an appropriate "modified" MDG for this group. For the EU-8, who have minimal absolute poverty but are significantly poorer than the 15 EU member states they have joined, a modified MDG could be to reduce poverty by half, assuming the poverty line to be the lowest among the EU-15.[21] Overview table 2 shows that, despite recent progress, all subgroups face a real challenge in poverty reduction. The required growth rates are significantly higher than the rates at which these countries are expected to grow. Moreover, as was the case in figure 17, no change in income distribution is assumed. With worsening inequality, either the goals would not be achieved, or the required growth rates would be even higher.

As with income, countries in the Region will continue to face challenges on nonincome dimensions of well-being. This is most simply characterized through the prospects of attaining the MDGs on education, health, and the environment, which in many ways represent a subset of aspirations on the nonincome side. The World Bank (2005) projects the likelihood that countries will attain the MDGs, based on recent trends in the indicators. It concludes that the

OVERVIEW TABLE 2

Achieving Subgroup-Appropriate Poverty Reduction Targets over the Long Term (2015) Will Require Significantly Higher GDP Growth Rates

Groupings	Long-term growth rates required to meet targets *	Medium-term growth forecast (2002–7)**	Specific target	Baseline poverty rate (2002)***
Low income CIS	5.6%	3.9%	Reduce poverty by half relative to 1990 (at $2.15 a day)	52.3%
Middle income CIS	9.7%	6.8%	Eliminate economic vulnerability (at $4.30 a day)	39.6%
SEE	10.8%	5.4%	Eliminate economic vulnerability (at $4.30 a day)	55.3%
EU-8	6.6%	4.3%	Reduce poverty by half, taking as poverty line the lowest line in EU-15 today	36.6%

Source: World Bank staff estimates; growth rates are from GEP.

Note: * Subregional country averages weighted by GDP. ** GEP, *Global Economic Prospects* (World Bank 2005b). *** Population weighted.

attainment of the nonincome MDGs in the Region is not assured. The health MDGs, which require reductions in child and maternal mortality and effectively combating the spread of communicable diseases such as HIV/AIDS, represent a challenge in many, if not most, parts of the Region (see overview box 2). For the low income CIS group, most MDGs—including improvements not only in health but also in education and water supply—remain a challenge. Thus, taking both the income and nonincome dimensions into account, the picture is one of a recovering Region, but one where much still remains to be done.

The Role for Public Policy

It is clear from the above that accelerated and shared growth, along with reform of public service delivery and better targeting of social programs, will be key to making progress on both income and nonincome dimensions of poverty. It is also important to be able to monitor progress in poverty reduction. Within these four areas, what are the priority actions for public policy?

Accelerating Shared Growth

It is difficult—based on the experience of the past five years—to overemphasize the importance of raising and sustaining high rates of growth for poverty reduction. As the simulations in overview table 1 suggest, accelerated growth is essential for poverty reduction. The EU-8 is already well placed to take advantage of the new economic opportunities and market integration provided by EU accession. Enhanced competition and the mobility of both products and factors of production that EU accession provides will likely become a dynamic source of growth in the future. This is also true, but perhaps to a more limited extent, for countries with the prospect of accession. But for low and middle income CIS countries that do not yet have such an external driver for change, domestic catalysts remain crucial. Good economic governance and responsible leadership must take advantage of the relatively good economic times to put into place policies and institutions that would enhance growth.

Understanding the policies and institutions that lead to strong and sustained rates of growth is therefore a first step in reducing poverty. While this report has less to say on factors that drive growth—which is not the focus of this study—the pursuit of sound economic policies is a necessary precondition. These include sound monetary and fiscal policies (reflected in, for example, moderate-size government and low inflation), a climate conducive for investment, a relatively well-developed financial system, and trade openness. Countries of the Region are, with few exceptions, relatively well integrated in world markets, although more can be done (World Bank 2005 Forthcoming c).

However, beyond these broad issues around promoting growth, the diagnosis in this report points to a number of areas where more could be done either to increase the assets of the poor or to create greater returns to their assets. These relate to (a) promoting enterprise reform, (b) boosting growth and productivity in agriculture, and (c) promoting opportunities for those in lagging towns and regions. The report considers each in turn.

Promoting enterprise sector reform. Encouraging the growth of new, more productive firms and strengthening the financial discipline for existing enterprises continue to be important for both poverty reduction and accelerated GDP growth. The typical economy of former socialist countries continues to face significant productivity differences across old, restructured, and new firms *within* the same sector (World Bank 2002h). New firms are typically the most productive, reflecting not just the more efficient use of resources but also the relative dynamics of different kinds of firms and the very different policy environment in which they function. This historic legacy of transition is reflected in the large earnings gap between the poor and the nonpoor as many of the workers belonging to poor households are trapped in the old, unrestructured, low-productivity firms. Accelerating reform of the enterprise sector and of the business climate as a whole to create a level playing field across all firms and—in particular—to encourage the entry and growth of new firms is thus an important factor for equalizing the returns to labor and reducing poverty. This is particularly important for CIS countries, which despite recent progress continue to lag behind other countries in ease of doing business (World Bank Forthcoming d).

Boosting growth and productivity in agriculture. Many of the poor in the Region are in rural areas, where poverty is proving more resistant to growth than in urban areas. Agriculture is the main activity in rural areas; thus, stimulating agricultural growth is crucial for poverty reduction. Where land reforms have been implemented, especially where initial conditions favor labor-intensive cultivation (low income CIS), land distribution resulted in significant productivity and income gains to rural households. Where land reforms are incomplete (for example, some middle income CIS) or where land market operations need to be improved to facilitate land restructuring (for example, in SEE), significant income gains can be attained from accelerated reforms. In all countries, future gains in reducing poverty in rural areas would hinge on eliminating key market imperfections in input and output markets essential for enabling self-employed farmers to lift themselves out of poverty. In particular, the integration of rural areas into national credit markets is critical for further investments and productivity growth in agriculture. More broadly, improving the investment climate in rural areas is very important. Increasing evidence shows that investments in food processing, agribusiness, trade, and retail companies play a crucial role in helping small farmers overcome input and output market imperfections, in helping them upgrade the quality of their products, and in accessing markets (World Bank 2005a). Beyond measures related to agriculture, integration of the rural poor into national labor markets—either through rural off-farm employment or by improving access to urban labor markets—and adequate social safety nets will be crucial for sustained income growth and poverty reduction, particularly in the middle income CIS and SEE countries. Emphasis on rural service delivery and infrastructure is also critical, especially in the low income CIS, not only for its instrumental role in raising rural incomes, but also as an aspect of poverty that warrants attention in its own right.

Promoting opportunities in lagging regions. Countries in the Region face substantial differences in poverty rates between urban and rural areas and between capital cities and smaller towns that, if severe, risk perpetuating intergenerational poverty and inequality traps and act as a drag on economic growth. Most countries seek to address regional inequalities through the maintenance of a stable macroeconomic environment, the creation of a level playing field for businesses, and fiscal transfers for targeted programs in lagging regions. But more can be done. First, countries need to enhance labor mobility. When people move to economic nodes that promise a higher expected income, it helps to reduce spatial income disparities. Adoption of appropriate policies to encourage movement, supported by the development of urban housing markets and policies, credit markets, and entitlement reform can provide a strong stimulus to inter- and intraregional mobility and help improve income levels in relatively poorer areas while also boosting competition, productivity, and growth in destination areas. Second, in countries with decentralized fiscal systems, there is a strong role for equalizing resource transfers to address regional inequalities. In particular, social and economic reforms in the lagging regions can be encouraged through market-based incentives, including the use of competitive allocation mechanisms for fiscal transfers. Third, education and health service delivery should be strengthened in lagging regions to ensure adequate human capital formation as a route out of poverty. In particular, existing inequalities in access to public services and quality of services provided need to be addressed as a priority.

Strengthening Public Service Delivery

Ensuring access and improving quality of education and health care require strengthened accountability arrangements. Although low levels of spending are an issue, more so in education than in health care, only a few countries spend less than is warranted, given levels of income. Thus, going forward, most countries will need to operate within the available resource envelope. Reforms will therefore have to focus on improving the quality and efficiency of public spending.

Enhancing quality and equity of education services. In education, the low income CIS group needs to stem the decline in primary enrollments and quality of education, in particular by ending the situation in which staff are underpaid and complementary expenditures (on textbooks, heating, and repairs) are underfinanced, while at the same time employment and, in some cases, facilities remain well above standards common in much richer countries. In addition, some countries may need to ensure greater equity in education spending across subnational regions (for example, the Kyrgyz Republic). Ensuring access to primary education is much less of an issue outside the low income CIS countries. Here the main issue is secondary education, where quality and relevance to market demand are often in question. Governance reforms that both strengthen government accountability for outcomes as well as increase participation and voice will be essential to improving outcomes. Lessons from the experience of the EU-8 in raising quality certainly point in this direction. In particular, decentralization of services to allow for a greater role for both school administrators and parents has an important role to play in stemming declines in quality.

Strengthening access to, and quality of, health care. In health care, low-income countries suffer from having to provide for a range of services when budget resources are limited, but even the available allocations are not spent wisely. This is reflected in the large share of household contributions in total health spending. Improving utilization among the poor is closely linked to financing and quality issues. Tough decisions are required on the size of the basic package and a major reallocation of expenditure—and greater accountability for its use—implemented to improve access to, and quality of, care (World Bank 2005d). To improve matters, accountability relationships between politicians and citizens need to become more effective (through such means as more organized voice power of citizens, citizens' report cards, and informed voting), and the accountability relationships between politicians and providers need to be strengthened (through such means as clarifying responsibility, aligning incentives between policy maker as principal and provider as agent, and better enforcement of contracts between organizational and front-line providers). Countries such as Armenia have shown that, even with limited resources and high poverty rates, improvements in key dimensions such as affordability can be made, albeit on a moderate scale. At the other end of the spectrum, the EU-8 is struggling to maintain the easy access to a wide range of health services in a context of rising costs. Clearly, further efficiency-enhancing mechanisms as well as private financing will need to be found to control expenditures.

Managing reform of utilities. Service quality in many of the infrastructure services is extremely poor in the low income CIS countries, and even in richer countries there are large disparities between service quality for the poor and the nonpoor. The infrastructure needs of the poor are unlikely to be met without reform of the utilities sector to bring it to a financially self-sustaining basis, which would encourage much-needed upkeep and maintenance of viable infrastructure and improvements in service quality. Improving financial performance will involve raising tariffs, which—except for power, where there has been some movement toward cost recovery, and possibly water in the EU-8—are well below cost recovery levels. Further movement toward full cost recovery in power is expected to have a limited impact on poverty, except in the poorest countries. However, across-the-board increases in the full range of utilities is expected to have a more serious impact on poverty (World Bank 2005 Forthcoming b). The social impact of tariff increases will need to be factored into the sequencing and pace of reforms in the event of across-the-board reforms in a range of utilities. Where the social safety net is adequate, it can be expected to mitigate the impact on the poor. However, where social safety nets are relatively thin, as for example in the low income CIS group, other options are worthy of consideration. For utilities that can be metered, lifeline tariffs can serve as a useful temporary cushion; however, where lifelines are not practical (as, for example, in sectors where consumption cannot be measured), reforms would need to be calibrated to affordability.

Enhancing Social Protection

Strengthening the social safety net. Given their importance for poverty reduction and the broad improvements over time, it should be clear that countries need to maintain ongoing social insurance and social assistance reforms, which are largely designed to improve sustainability, and to enhance coverage and targeting of the poor within the available resource envelope. In the low income CIS group, the main constraint will continue to be the fiscal means to cover the population adequately. In the middle income CIS group and SEE, although there is more fiscal space for social protection, there is also greater resistance to reforms, as suggested (for example) by the difficulties with the monetization of privileges in Russia. While the objective of the reforms is not in question, the difficulties in implementation serve as a useful reminder of the importance of sequencing with other social and economic reforms, the need to protect the most vulnerable groups, and an appropriate communications strategy to explain the benefits of reforms. Where systems are more generous, as for example in parts of SEE and the EU-8, a balance will need to be struck between the need for social protection and labor market incentives.

Strengthening targeted interventions for marginalized groups and minorities. This may be in the form of assistance in cash or in-kind (such as education, health, or housing), depending on the nature of the group. For the long-term unemployed or nonparticipants, active labor market programs can be particularly relevant. But evidence from successful training programs suggests that these should be targeted, offered on a selective basis, with clear links to potential employers, and in collaboration with the private sector. It is important to bear in mind that there is limited evidence of successful retraining programs from the low income CIS group. In some cases, interventions may need to be integrated across many fronts. For example, for the Roma minority of the EU-8 and SEE, governments are taking a holistic approach to ending persistent exclusion by setting goals in four areas—education, employment, health, and housing. Other minorities may require a different approach. The elderly, especially those who are very old or living alone, may also require special interventions such as supplementary cash benefits or provision of assisted living services. For most marginalized groups, however, additional assistance, whether in cash or kind, need not be provided by the public sector alone. Civil society organizations, community-based groups, and other organizations could also be encouraged to come into the sector under the overall direction of the government.

Ensuring adequate minimum wages. Minimum wages are an important policy instrument for enhancing the income security of the poor. These can help provide a floor to income, but need to be kept at a reasonable level. In this context, the large real increases in the CIS in recent years have brought minimum wages closer to subsistence levels. However, future increases in minimum wages need to be considered carefully, so as not to become so high that they have negative effects on growth and employment, with adverse impacts on poverty. Where variations in regional income and labor market profiles are large, governments may need to consider setting region-specific minimum wages, which may help improve the employability of certain groups of workers (such as younger workers and those in lagging regions). This is an issue particularly in the EU-8 and SEE, where minimum wages represent a relatively high proportion of the average wage and the adverse impact of common minimum wages is particularly noticeable. For example, the relatively high minimum wage is found to constrain employment opportunities for the low-skilled in countries such as Lithuania and Poland.

Monitoring Progress on Poverty Reduction

Huge progress has been made in recent years in improving the quality and accessibility of poverty data. Countries need good survey data to monitor changes in poverty and to evaluate the impact of specific policy actions on the poor. This report documents significant progress in collecting up-to-date high-quality data across the Region. The previous report on poverty (World Bank 2000a) relied on a single survey for many countries and could produce an estimate of poverty over time for only three countries. With full data sets closed to users outside statistical offices, the report also had to rely on partial data. Since then, many countries have started implementing regular surveys that periodically collect representative data on income and nonincome dimensions of living standards. In addition, data are provided openly to researchers for the purposes of study and policy evaluation. These improvements are not only confined to EU-8 countries (for example, Hungary) but also cover SEE (for example, Romania), middle income CIS countries (for example, Kazakhstan), and low income CIS countries (for example, Georgia and Moldova).

But many challenges remain. First, improvements to data quality and availability are very recent, and for many countries in the Region reliable data on poverty changes can be obtained for only a few recent years. The efforts in collecting data need to be maintained. Second, survey coverage and response rates have fallen over time in all countries, and there is a need to strengthen the technical capacity of statistical offices to curb this trend and deal with it appropriately. Third, wide gaps exist in data collection on the nonincome dimensions of poverty: there are practically no attempts to gauge trends in the quality of health care and infrastructure services, and even indicators of access are not consistently collected. Given the changing nature of poverty with the increasing role of nonincome components, this gap is the most worrying. Fourth, not all countries have opened their data sets to researchers, undermining the effective use of public funds spent on data collection and monitoring. These areas—keeping up with periodic surveys to provide comparable data, collecting information on nonincome dimensions, and opening up access to survey data—are priorities for action to ensure adequate information support for poverty reduction efforts. (See overview box 3 for a discussion of the data used for this report.)

Conclusions

The countries in the Region have made significant progress in reducing poverty. More than 40 million people moved out of poverty during 1998–2003. Much of this poverty reduction derives from the growth rebound in the CIS countries. But poverty and vulnerability still remain a significant problem: more than 60 million are poor, and more than 150 million are vulnerable. Most of the poor are the working poor. Many others face deprivations in access and quality of public services. Regional inequalities both between and within countries are large. The highest levels of absolute poverty are found in poor countries of Central Asia and the South Caucasus, but most of the Region's poor and vulnerable are in middle-income countries.

Notwithstanding the tremendous heterogeneity among countries in the Region, reducing poverty and vulnerability requires an acceleration of shared growth, strengthening of public service delivery, better targeting of social protection, and regular monitoring of progress in poverty reduction across the Region. In promoting accelerated shared growth, the report emphasizes (a) further reform of the enterprise sector to encourage the release of resources from the old, less productive sectors to the new, more productive sectors; (b) further reforms to promote agriculture and rural growth by integrating rural areas into the rest of the economy with regard to labor and capital markets, access to credit, trade and services; and (c) policies to promote greater opportunity in lagging regions. Public service delivery needs to be improved through increasing the accountability of

OVERVIEW BOX 3

Data for This Report: The World Bank's ECA Household Survey Archive

To arrive at the internationally comparable assessment of poverty, this report uses primary unit record data from recent household surveys to construct a comparable indicator of living standards across all countries in the Region. Income data, an alternative to consumption for measuring living standards, remain particularly difficult to collect in transition countries. In contrast, practice has shown that consumption data can be gathered with a great degree of precision. Survey consumption modules have become more detailed over time and better capture various dimensions of consumption.

In relying on consumption of goods and services by a household as the measure of living standards, a number of conceptual and practical issues needed to be addressed. First, unlike food, consumer durables and housing are consumed over a long time. It is customary, therefore, to include the imputed value of the consumption flow associated with the possession of consumer durables (including housing), but exclude the expenditure on the purchase of these goods. However, for the Region, data availability limits the application of this approach to all countries. This report does not, therefore, include estimates of flow of services of durables, nor have researchers added in durable purchases or rents. Second, when consumption is used as a measure of well-being, higher consumption should indicate a higher level of well-being. For most consumption items, this correspondence is reasonable; however, for some categories, such as health expenditures, this correspondence is questionable. As a result, health expenditures were not included as a part of consumption (Deaton and Zaidi 2002). Third, given the significance of spatial differences, the authors adjusted for spatial price differences, using the same set of information in all countries. In the cases where data

government and the voice and participation of citizens. This is essential to improving access and quality of social services, which are not only important in their own right but also of instrumental value in helping the poor move out of poverty. The report emphasizes the need to further strengthen the social safety net to meet the challenges of restructuring economies. Finally, monitoring progress on poverty reduction on a regular basis needs good-quality household survey data sets that are publicly available for research and analysis.

Endnotes

1. All monetary amounts are in U.S. dollars ($) unless otherwise indicated.
2. The new member states of the European Union are the Czech Republic,

were collected over a long time, it was also necessary to adjust for changes in prices over time. Fourth, households in the Region cope with poverty by relying on an array of nonmarket strategies, including producing their own food and engaging in reciprocal exchange with other households and institutions. A consistent approach was used in assigning a monetary value to these components of consumption. Fifth, to adjust for differences in household composition, researchers took the simplest approach and used the per capita scale. Sixth, the procedure, which conforms to methods used in other international household survey data depositories (such as the Luxembourg Income Study; see Gottschalk and Smeeding [1997] and www.lisproject.org) was used to clean the data of outliers across all data sets.

Following a consistent approach across all data sets gives reasonable confidence that differences across countries in the final consumption measure are due to differences in the primary data and are not due to the method of aggregation. This is the first time (to the authors' knowledge) that comparable consumption aggregates have been constructed for countries in the Region. (Full details are provided in appendix A, Data and Methodology.)

The constructed estimate of real per capita consumption has several shortcomings that reflect some persistent data problems in the Region. First, it ignores the differential impact of price increases on the poor and nonpoor. No price indices for low-income groups that would allow this issue to be addressed are routinely available in the Region. Second, over time, there has been considerable deterioration in response rates in many countries. Countries deal with this problem in different ways, which may have (as yet unknown) implications for survey-based poverty and inequality measures. Notwithstanding these limitations, consumption indicators constructed for this report produce a reasonably reliable anchor to assess changes in poverty and distribution during 1998–2003.

Sources: Deaton and Zaidi 2002, Gottschalk and Smeeding 1997, and www.lisproject.org.

Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.

3. Countries in SEE consist of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the former Yugoslav Republic (FYR) of Macedonia, Romania, and Serbia and Montenegro; the subregion also includes a territory of Kosovo, now UNMIK.
4. Middle-income countries in the CIS are Belarus, Kazakhstan, Russia, and Ukraine.
5. Low-income countries in the CIS are Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.
6. The Commonwealth of Independent States includes all countries that were part of the Former Soviet Union, except for the three Baltic republics, Estonia, Latvia, and Lithuania, which acceded to the European Union in May 2004.
7. The analysis of poverty trends uses data from 15 countries in the Region for which comparable representative surveys are available over the entire

1998–2003 period or its significant part: Armenia, Belarus, Bosnia and Herzegovina, Bulgaria, Estonia, Georgia, Kazakhstan, the Kyrgyz Republic, Lithuania, Moldova, Poland, Romania, Russia, Tajikistan, and Uzbekistan. The appendix to the study discusses country coverage in detail.

8. Aggregate poverty figures include Turkey in addition to the Region's poverty headcount, and thus refer to the ECA Region as defined by the World Bank.
9. Many of these poverty lines have been drawn in-country from household survey data and represent a level of consumption that would allow a typical household to meet international minimum caloric requirements, with an additional allowance for nonfood basic needs. They are a far cry from the outdated and questionable poverty lines used in many countries in the early years of the transition.
10. The first 15 member states of the European Union are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.
11. For the purposes of discussing poverty risks in the EU-8 countries and selected countries in SEE and the middle income CIS group, we use a higher poverty line of $4.30. The $2.15 line catches a fairly small proportion of the population in these countries and thus may not provide robust results.
12. For the reasons explained in the appendix, we use *consumption* as an indicator of welfare at the household level. The other often applied measure—*income*—tends to show much higher levels of inequality, but it suffers from severe problems of underreporting in many transition economies; it is unclear whether high levels of income inequality are driven by the noisy data. To deal with this problem while comparing levels of inequality in the Region with other countries, we consistently rely on consumption-based indices.
13. The Gini coefficient is a standard measure of inequality: it takes values between 0 (complete equality) to 1 (extreme inequality, when all income is appropriated by the richest person) (see details in the appendix).
14. The point here is not whether relative or absolute notions of inequality are "right," but simply that people's perceptions of inequality are different from how economists have chosen to measure it.
15. Employment rates among women do not compare unfavorably with those of men, except in a few countries such as Bosnia and Herzegovina and Tajikistan.
16. Targets agreed to at the Lisbon Summit in March 2000, where heads of state and governments of the European Union decided that the EU should adopt the strategic goals for the next decade of becoming "the most competitive and dynamic knowledge-based economy [with] greater social cohesion." The 70 percent employment rate for the working-age population is one of such targets.
17. Georgia (not depicted here) is another country where the incomes of the poor have declined in real terms.
18. Thus, trends in wage inequality are mixed, with inequality falling in some countries and rising in others.
19. The MDGs represent an international effort to promote poverty reduction and human development by establishing measurable yardsticks for

eight goals to be achieved by 2015. To achieve the child and maternal mortality MDGs, countries would have to reduce child mortality by two-thirds and maternal mortality by three-quarters by 2015. The 1990 benchmark against which progress is assessed is often not suitable for the Region's countries because many social indicators reached their nadir in the mid-1990s or later. The projections made by the World Bank are based on recent trends in the indicators (see World Bank 2005c for further details).

20. In technical terms, the elasticity of poverty reduction to growth has proved to be high for the most part.
21. Portugal has the lowest poverty line: around PPP $7.50 per capita per day.